Cave's Quarterly

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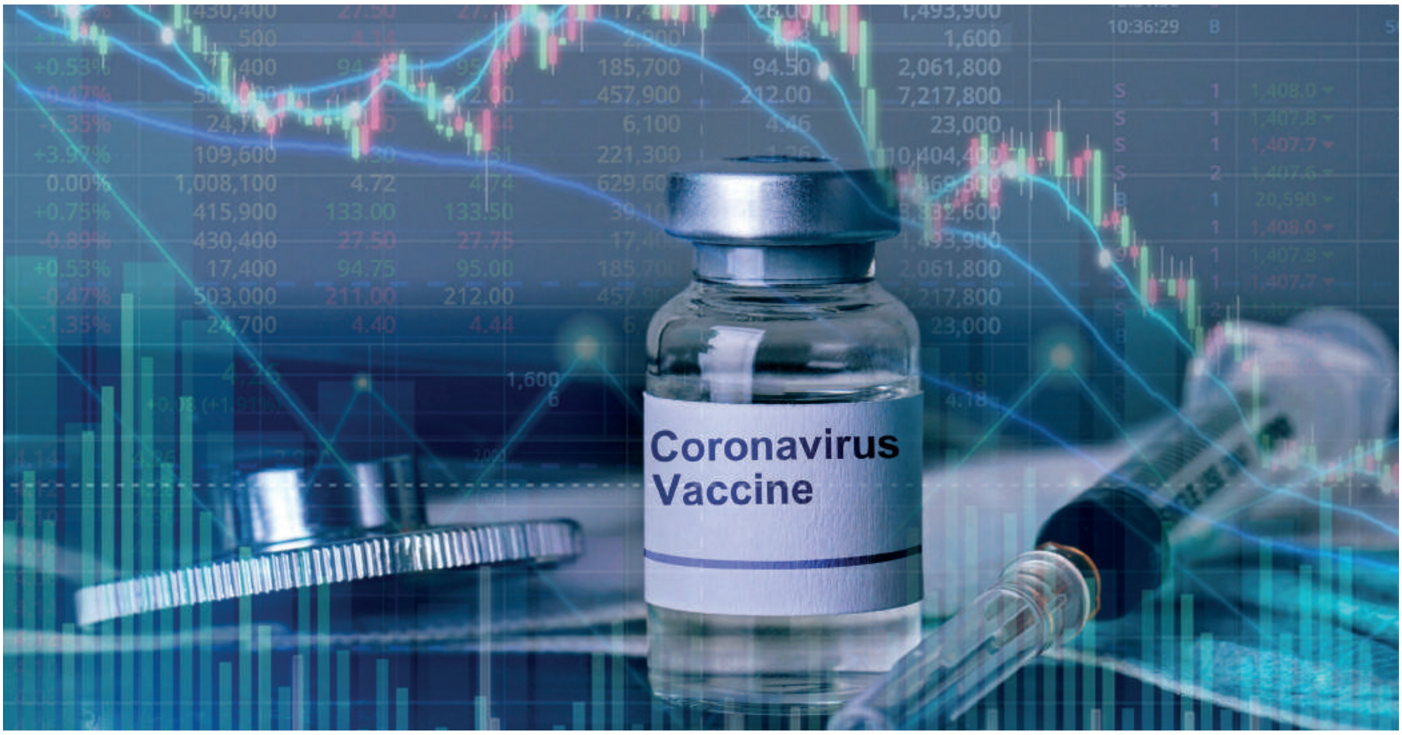
Edition 20, Q4 2020 Round Up

2020 ends in tiers

A new variant of Covid-19 saw the UK experiencing a severe second wave of virus infections, pushing the NHS close to breaking point through December. Prime Minister Boris Johnson was forced to intervene with 'lockdown-esque' restrictions which saw the British Christmas, a time traditionally spent with family and friends, effectively cancelled. With more than three quarters of England placed under the strictest level of coronavirus measures, 2020 will be looked back on as a bleak year that ultimately ended in tiers.

Previously flagged as one of the key market risks coming into the year – the US election – proved to be a bit of a non-event. Whilst President Trump has so far failed to concede the result, the Democratic candidate Joe Biden secured enough Electoral College votes to win (subject to court challenges and recounts) and markets seem confident that he will be inaugurated as the next president of the United States on 20th January.

Despite the rapid increase in global Covid-19 cases being reported, the disconnect between stock market valuations and the real economy expanded in recent months. November will likely be marked as a turning point in the fight against the pandemic as over three consecutive Mondays during the month, some of the world's largest biopharmaceutical companies announced vaccine breakthroughs; Pfizer and BioNTech were the first to conclude phase III studies after demonstrating higher than expected efficacy of 90%. Moderna followed up with a 95% efficacy rate and the UK based partnership between AstraZeneca and the University of Oxford delivered a less effective, but still highly encouraging 70%. With an end to the crisis seemingly in sight, global equities rallied strongly through the fourth quarter, as investors largely ignored the significant logistical challenges of distributing vaccines on a mass scale.



Global Equities

Here in the UK, the quarter ended with a post-Brexit deal on trade and other issues being agreed on Christmas Eve, just one week before the transition period between the UK and the EU was due to come to an end. More than 1,000 pages of legal text was published, outlining the future relationship between the two parties, and providing clarity on an issue that has dogged the UK equity market since the 2016 EU Referendum.

After years of lagging regional peers, our domestic stock market is emerging from the Brexit shadows and may finally have a platform for a period of outperformance. With the market narrative shifting from the need for more central bank support to the potential for a vaccine-driven, global recovery, there have been early signs of investors rotating away from shares in high growth companies towards more cyclical value stocks. Given its significant exposure to financials and economically sensitive sectors such as energy, mining and leisure, the UK's FTSE All Share index was a key beneficiary of this recent style shift, registering a 12% gain over the 3-month period.

In the US, concerns over rising infection rates were overshadowed by the medical breakthroughs, authorisation of a long-awaited $900 billion pandemic relief plan and the well-received election outcome. With the US Federal Reserve maintaining an ultra-accommodative policy stance, the economic outlook remains healthy across the pond. Expectations for a more diplomatic approach under president-elect Joe Biden helped fuel a rally in US equities which saw the S&P500 and Nasdaq indices advance for a third consecutive quarter, up 12% and 15% respectively.

Renewed lockdowns heading into the Winter months proved a worthwhile exercise in Europe, with infection rates across the region peaking in November. With the €750 billion 'Next Generation EU' fund now approved, the post-vaccine period could deliver strong growth for the Eurozone economy, which was dealt a severe blow from the pandemic owing to the region's heavy reliance on global trade. The lack of technology sector exposure, coupled with a recent pickup in economic activity and robust demand from China, helped push the Euro Stoxx 50 index 11% higher across the fourth quarter; previously hard-hit sectors such as industrials, energy and financials were amongst the best-performers.

The Chinese economy returning to pre-pandemic output levels has been driving a powerful recovery dynamic across Asia and the Pacific in recent months. Vaccine developments and the election of Joe Biden has boosted risk appetite further, with investors anticipating an improvement in foreign policy relations between the world's two largest economies going forward. A notable increase in global trade activity, combined with US dollar weakness, helped to amplify returns across a region already benefitting from a less severe Covid-19 outbreak. In the 3 months to the end of December, the Shanghai Composite index added 8%, the Hang Seng Index gained 16% and the Nikkei 225 index rose 18%.

Commercial Property

Prospects for the UK commercial property sector remain gloomy against a backdrop of rising virus infections and the recent tightening of restrictions. Indeed, the severity of localised restrictions was there for all to see as an eerily subdued city of London welcomed in the New Year with empty streets, bars, and pubs. Despite massive amounts of stimulus, the pace of our economic recovery has so far been muted and investor sentiment is weak given the challenges faced by many tenants to meet ongoing rental commitments. Excluding the supermarkets, general retail continued to deliver negative returns and the leisure and hotels sector has unsurprisingly struggled. The outlook for office landlords has also darkened due to concerns over a permanent shift to more home working.

Alternatives

The November vaccine news fuelled hopes for a rebound in the global economy, providing a boost to commodities in the fourth quarter. The price of crude oil rallied 24% to $51.80 per barrel as expectations for higher demand in 2021 offset concerns over rising inventory levels. Demand for industrial metals across Asia was also strong, with a resurgent China driving healthy gains in copper, lead, and aluminium markets.

Precious metal prices were mixed, with silver higher and gold flat, as investors embraced risk and rotated out of perceived safe-haven assets. Having enjoyed a sharp rise this year, gold retreated from its August peak to close out the calendar year at $1,898 per ounce, propped up by expectations for rising inflation and a weaker US dollar (historically, the strength of the dollar and precious metal prices have been inversely correlated.)

Fixed Interest

In fixed income markets, interest rates were maintained around historically low levels with global central banks growing their asset purchase programmes to stimulate economies; the Bank of England announced a £150 billion expansion, the US Federal Reserve committed a further $80 billion per month to Treasuries and the European Central Bank increased the size of its planned asset purchases by a substantial €500 billion. The US 10-Year Treasury Note ended the quarter with a yield of 0.9%, slightly higher over 3 months. The UK 10-Year Gilt yield was flat at 0.2%.

The insatiable search for yield and a less pessimistic economic outlook saw high-quality, investment grade bonds continue to outperform their government counterparts. Higher up the risk spectrum, non-investment grade credit and emerging market bonds were the strongest performing categories within fixed interest.

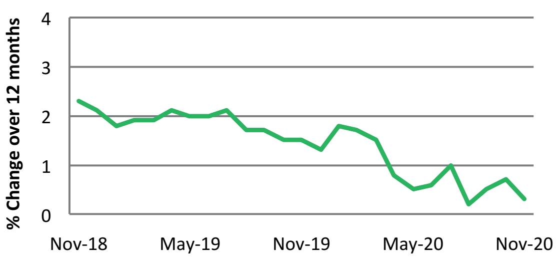
Outlook

Looking ahead, we anticipate a challenging year with investor sentiment likely to be driven by lingering Covid-19 uncertainty and inconsistent economic recovery data. We see vaccine delays and rising infection rates as the headline risks to equities in the short term. We are also mindful of overexuberance among retail investors, particularly prevalent in the Tech and Crypto-currency sectors, and the potential for rising bond yields (alongside better prospects for economic growth) which could prove a headwind to both fixed income and equity markets.

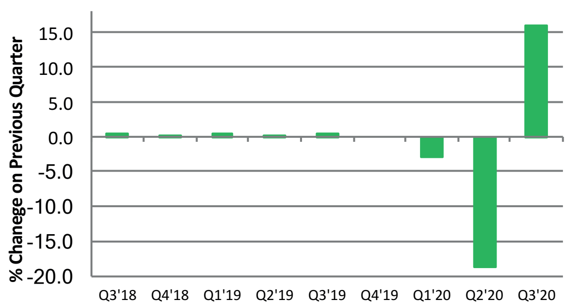
2020 served as a reminder that, although stock markets often have downturns and can experience extreme bouts of volatility, the general direction of travel for investors willing to stay the course and focus on fundamentals is upwards. Strong returns across most asset classes in recent months may limit further wholesale gains in the near term but opportunities for stock selection remain plentiful in the undervalued and overlooked areas of the market. As ever, we remain (for the most part) fully invested and will be focusing on diversifying across the regions and sectors with the strongest prospects for attractive long-term returns.

A year in numbers

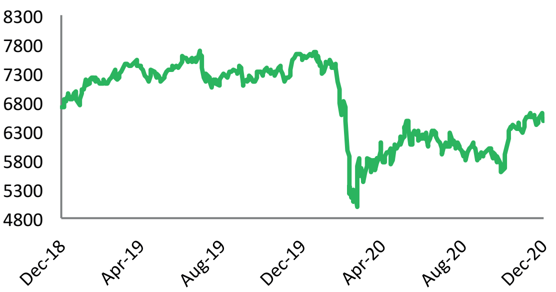
UK Consumer Prices Index (CPI)



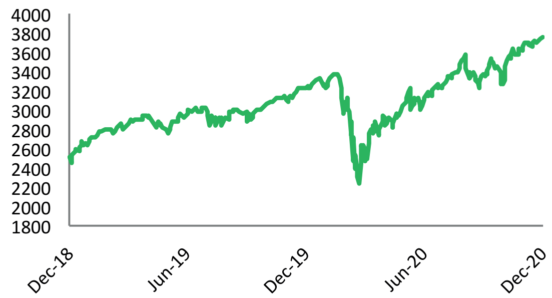
UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index



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Head Office Lockgates House, Rushmills, Northampton NN4 7YB
Tel: 01604 621 421 **Fax:** 01604 234 335
Email: info@caves.co.uk **Website:** www.caves.co.uk

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